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Testimony of

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Testimony

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Subcommittee on Water and Power

"Opportunities and Challenges on Enhancing

Federal Power Generation and Transmission"

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Mr. Chairman, members of the Subcommittee, thank you for this opportunity to appear before you to discuss the challenges and opportunities facing the federal Power Marketing Administrations (PMAs). I am Thomas J. Heller, CEO of Missouri River Energy Services (MRES).

Background

MRES is a municipal joint action agency comprised of 58 municipal utilities located in the states of North and South Dakota, Iowa and Minnesota. All of our member communities receive allocations of federal hydropower from the Western Area Power Administration (WAPA), and this federal power meets roughly 50 percent of their power supply needs. MRES serves as the supplemental power supplier for its members, providing the remainder of their power supply needs – in addition to transmission, scheduling and other services – through our member-owned and financed facilities. Currently, we hold an undivided interest in the Laramie River Station coal-fired power plant in Wyoming; own and operate oil-fired facilities in Watertown, South Dakota, natural gas-fired facilities in Exira, Iowa; and wind generators in Worthington, Minnesota. In addition, we are participating in feasibility studies for two new coal-fired power plants and have plans to expand our investment in wind resources. While we own some transmission facilities, we are primarily dependent on the transmission facilities of others – WAPA, public power systems, and private utilities – to deliver power from our generation resources to our member communities. MRES is also a non-transmission

owning member of the Midwest Independent Transmission System Operator (MISO) and roughly half of our load is located within the MISO "footprint."

WAPA markets power generated at the Bureau of Reclamation and Corps of Engineers multipurpose dams in five distinct marketing areas. MRES members receive power from the Upper Great Plains Region of WAPA which is the Eastern Division of the Pick-Sloan system, with the power generated at the dams on the Missouri River. Collectively, our members purchase nearly 20 percent of the firm energy marketed by WAPA in this region. The Eastern Division Pick-Sloan system includes eight power plants with a combined installed capacity of over 2,500 megawatts and over 7,800 miles of transmission lines.

Consistent with MRES' role as the supplier of power to its members, above the fixed amounts they purchase from WAPA, MRES interacts regularly with WAPA to coordinate both on administrative matters such as scheduling and dispatching power deliveries to MRES members, accounting for deliveries from each, addressing PMA policy matters, and conducting transmission studies. As a result of this coordination, MRES has a strong working knowledge of WAPA's operations and issues as they concern the Upper Midwest.

As many of you know, the region has been suffered under a severe and continuing drought. As a result, WAPA is marketing only a fraction of the energy that it can provide in a normal water year. WAPA is incurring significant purchase power expenses to

replace the lost hydropower and meet its contractual obligations to federal power customers in the region.

As we move forward, WAPA faces both opportunities and challenges. How WAPA, its customers and Congress respond to the realities of tightening federal budgets, increasing environmental requirements, the continued drought, and the need for additional generation and transmission resources will shape the future value of WAPA and its ability to continue to play a positive role in the provision of affordable, reliable electric service.

Mr. Chairman, no challenge is greater than the proposal contained in the Administration's budget to tax federal power customers - jumping 20 percent each year until PMA rates match those of "the market." While the budget claims this change is needed to redress so-called "subsidies," the fact is that federal power customers repay - in full and with interest - the federal investment in the power component of these multipurpose water projects. This radical proposal would overturn nearly a century of statutory requirements that federal power be sold at cost-based rates and would devastate the financial well-being of our members and their communities. The first-year impact of this proposal on MRES members would be roughly $7 million. This is placed on top of an already scheduled increase of nearly 20 percent in 2005 and a proposed increase of nearly 20 percent in 2006 that our members will see in WAPA rates from the recent drought. The proposal would double our members' rates in less than four years, extracting a total of roughly $60 million from our communities.

Generation: Opportunities and Challenges

1. Maintaining and Optimizing Existing Federal Generation Resources

WAPA markets power from facilities owned and operated by the Corps of Engineers and Bureau of Reclamation. These are multipurpose projects designed to meet a number of public objectives in addition to power generation – water supply, flood control, navigation, irrigation, recreation and fish and wildlife protection. In addition, the two operating agencies have other responsibilities at other projects throughout the country. This multiplicity of responsibilities, coupled with tightening federal budgets, means that project replacements, additions and improvements do not also happen on a schedule and in a manner that best serves the needs of the power customers.

Put another way: relying exclusively on federal appropriations to the Corps of Engineers, Bureau of Reclamation and WAPA would mean that some important projects – turbine rewinds, runner replacements, and transmission improvements – would be delayed or deferred. It is important to recognize that this delay can prove very costly, when a deferred repair becomes an expensive replacement – often coupled with a long outage that requires costly replacement power purchases.

In response to this reality, MRES joined with other municipal and cooperative utilities in the region to form Western States Power Corporation (Western States). Through Western States, power customers provide advance funds that are used to make capital investments, as well as covering shortfalls in Operations and Maintenance (O&M) budgets. The customers' investment is recovered as a bill credit from WAPA. To date, Western States has committed or advanced nearly $50 million in the Eastern Division Pick-Sloan region. Significant projects financed by Western States in the region include the turbine runner replacements at Yellowtail power plant in Montana for the Bureau of Reclamation and the rewind of the turbine generators at Big Bend for the Corps of Engineers (after Water Resource Development Act 2000 allowed the use of advanced funds). Western States is also working with WAPA to fund substation improvements and transmission line additions to help system reliability and integrate wind and other generation into the system.

The relationship between Western States and the federal agencies has been a successful partnership because of the integral role that customers play in the review, planning and oversight of the anticipated capital and operational budgets. This cooperative process allows customers to review and help set priorities, manage finances and ensure proper cost allocation.

However, it is important to realize that the purpose of Western States is to supplement, not replace, the traditional use of federal funds to finance capital investments and operational expenses. Not only is this our preference; it is a practical reality. Advance

customer funding has a limited use. The pool of money available to Western States to provide to WAPA on a type of revolving credit facility is limited to the amounts billed by WAPA to its customers for services rendered. As I noted, the advanced funds are returned in the form of a bill credit. Once the credit equals the customers' bill, there can be no further advanced funding.

MRES is aware that the Administration has proposed creation of an additional financial tool: use of customer receipts, where WAPA takes a portion of the funds collected from its power customers and sends it directly to the Corps of Engineers or the Bureau of Reclamation to cover O&M costs, as well as WAPA's own O&M expenses (rather than returning the funds to the Treasury and relying on appropriations). MRES supports, in concept, the use of customer receipts, but only if it follows the advanced funding model used by Western States and:

- Supplements federal appropriations rather than becoming the lone financing tool;
- Provides significant opportunity for customer involvement in setting and reviewing both near-term and long-term funding targets and project prioritizations and providing project and budget oversight; and

Customers' funds are used exclusively for those projects identified through this collaborative that benefit power customers, and not diverted to fund other agency responsibilities.

2. Threats to the Pick-Sloan Generation Resource

In addition to the threats that can occur from the degradation of equipment, the power output of the Pick-Sloan system faces two significant challenges: changes in river operations and sedimentation.

A bitter fight has gone on for years over proposed revisions to the Corps of Engineers' Master Manual for operation of the Missouri River. Upstate and downstate interests have fought over the comparative importance of recreational and navigation needs, all while the potential for an Endangered Species Act suit loomed. Well, the gloves came off about two years ago. American Rivers filed suit twice to impose its view of how the river should be run and, while its position has not been upheld, the cases are still alive and the operations of the Missouri River lies in the hands of the federal judiciary.

MRES has long supported a negotiated solution to this crisis that would make those changes needed to protect natural and recreational resources, while minimizing the impacts on power. Unfortunately, intransigence took the place of compromise, and I believe all of us will suffer as a result. MRES is the lone hydropower customer actively involved in the American Rivers suit that supported the government's position, and we will seek to ensure that the interests of power customers – as well as science – have a voice. The preliminary injunction that American Rivers initially won in the federal district court for Washington, D.C., to force a change in the flow regime of the Missouri River for August, 2003 was dissolved after the case was consolidated with a number of

related Clean Water Act cases in Minnesota. The change requested by American Rivers would have reduced WAPA's power generation during the peak demand season and potentially driven up power costs. MRES is the only party in the case to present that focus to the judicial proceedings. American Rivers' subsequent initiative requesting a federal court to issue a similar order for August, 2004 was dismissed by consent when it became plain that the lack of water in the Missouri River mooted their argument. These cases are still pending on appeal in the Federal Circuit Court of Appeals for the Eighth Circuit.

Mr. Chairman, there is another quiet crisis brewing: the rapidly accelerating sedimentation being deposited into the Missouri River. This sedimentation problem exists along the entire Missouri River system. The Corps of Engineers has estimated that annually 92,500 acre-feet of sedimentation will be deposited in the main stem reservoirs. This is equal to ten square miles at an average depth of 14.5 feet. In Pierre, South Dakota, runoff from the Bad River is dumping 3,500 acre-feet of silt into the upper end of Lake Sharpe every year. During winter months this build up of sedimentation constricts the river and has caused massive flooding in Pierre. Ice jams form on the river and required flows to be reduced, decreasing power output of the system. The federal government is now in the process of buying out 180 homes in the Pierre area at a cost of $35 million. The Corps of Engineers is also looking at the probability of buying homes in the Bismarck, North Dakota, area at an estimated cost of $100 million. This will be in addition to the homes already purchased in the Williston, North Dakota, area at a cost of $35 million. The total cost of these three areas is $175 million, yet the true severity of

the problem is not yet being addressed. MRES is a participant in the Missouri River Sedimentation Action Coalition – a diverse coalition seeking to educate the public and pursue creative solutions. Regrettably, the Corps of Engineers has failed to even address this issue in its final changes to the Master Operating Manual. This is a problem that begs attention from this Committee, and I would urge you to direct your staff to work with the Coalition and others on addressing this problem.

3. Leveraging the Federal System to Support Non-Federal Generation Resources

As I mentioned earlier in my testimony, there is a historic partnership between WAPA and its customers – the hydro-thermal integration. I believe there is an opportunity for a new partnership.

Hydropower is well-suited to integration with other resources: it can serve as a baseload resource that is supplemented with other supplies in order to meet peak demand; it can easily vary output in order to match fluctuating loads; and, it can provide regulation service to adjust for the variances in production from intermittent wind resources.

The Pick-Sloan region contains some of the best, untapped wind generation opportunities in the country. MRES and its members would like to utilize this renewable generation to meet our customers ongoing energy needs. One of the main challenges in using wind generation is overcoming the variability of wind. Hydro has great potential to cost

effectively provide the regulating resources for wind and dramatically improve the economics of that resource. MRES believes WAPA should allow its federal power customers to modify how WAPA delivers power to its customers, so that the customer can use its hydro allocation to provide the regulating resources it needs for wind resources.

On another note Mr. Chairman, WAPA has changed its marketing operations in California so that it now markets the energy generated by the system, with the customer left with the responsibility of firming the energy to account for variations in hydro conditions. This same option is available in the Northwest. MRES would welcome a discussion in the Pick-Sloan region of the options available for this firming responsibility.

Transmission: Opportunities and Challenges

As noted at the beginning of my statement, WAPA is a significant transmission owner in the region. In fact, most of the power generated at MRES facilities travels, at least in part, over WAPA's facilities before it is delivered to our member communities.

1. Using Federal Eminent Domain Authority to Site Transmission

As the members of the Subcommittee know, siting transmission facilities is a difficult task. This difficulty is one of the reasons that there is inadequate investment in transmission in this country – resulting in higher costs to consumers, reduced system reliability and illiquid wholesale power markets.

WAPA and the other PMAs are in a unique position to facilitate transmission construction since, as federal agencies, they have federal eminent domain authority. Today, WAPA is limited to building only the transmission that is needed to deliver federal hydropower to its firm power customers. As you are aware, a provision in last year's energy bill would have expanded WAPA's authority and enabled it to receive funds from third-parties to construct needed transmission additions.

MRES believes this is a novel idea worthy of consideration. If Congress is to proceed and chooses to provide WAPA with this additional authority, we would urge you to include the following guidance:

- This new authority must not distract WAPA from its core mission of operating the federal system, and marketing cost-based power to its firm power customers.

- It is essential that if WAPA builds transmission for third-parties, that WAPA customers aren't shouldered with the burden of this effort – either in an

inequitable allocation of costs or any diminution in WAPA's core obligations.

- Transmission must be priced under a rolled-in "postage stamp" rate over large geographic regions. While there are some transmission facilities – like generator tie-ins – that should be paid exclusively by a specific party, most investments in the transmission network benefit all customers on the system (especially over time). Using postage stamp pricing reflects this broad distribution of benefits, facilitates transmission construction, encourages generation development in the remote location where fuels (coal, wind, solar, etc) are located and promotes the integrity and reliability of the grid.

2. WAPA's Role in the Midwest Independent System Operator (MISO)

WAPA is not currently a member of MISO nor are its facilities included in MISO's operation.

I understand the concerns with MISO participation, and share those concerns – rapidly escalating costs, inability to secure long-term firm transmission rights, managerial independence and an absence of accountability, market complexity, and cost-allocation. However, simply staying out, I believe, is not a solution. Nor is it without consequences.

Without WAPA participation in MISO:

- MRES continues to pay "pancaked" transmission rates – paying rates to both WAPA and MISO – since our generation must move across the WAPA system to get to our load in the MISO footprint.

- Potential new generation in Wyoming and the Dakotas – coal and wind – could become "trapped," since the major load centers are in MISO and shipping across that "seam," into the market, is prohibitively expensive.

It is our hope that WAPA will work with MRES and others to solve the numerous problems within MISO, rather than staying out.

Conclusion

Mr. Chairman, WAPA is one of the true marvels of the federal government. It is a program that pays for itself, taps public resources to responsibly provide an essential public service, and has been an engine of economic growth.

Given the challenges of today, that positive role could diminish. Budget constraints could lead to deteriorating facilities, environmental requirements could reduce system output, and "old world" thinking could lead to missed opportunities.

But I'm not pessimistic. I believe we also face great opportunities, including:

- An expanded, collaborative arrangement between customers and the federal agencies to ensure the upkeep and expansion of the system;

- A responsible role in facilitating new generation and transmission; and

- A thoughtful approach to system management that solves problems – ESA compliance, sedimentation, and MISO participation – rather than merely hoping they go away.

Thank you for this opportunity, and I look forward to working with the subcommittee.